STATE OF CALIFORNIA GRAY DAVIS, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

July 25, 2002

TO: ALL PARTIES OF RECORD IN RULEMAKING 02-06-041

Decision 02-07-037 is being mailed without the Dissent of Commissioner Michael R. Peevey. The Dissent will be mailed separately.

Very truly yours,

/s/ CARL K. OSHIRO
Carl K. Oshiro, Interim Chief
Administrative Law Judge

CKO:eap

Decision 02-07-037 July 17, 2002

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Require California Natural Gas and Electric Utilities to Preserve Interstate Pipeline Capacity to California.	Rulemaking 02-06-041 (Filed June 27, 2002)

OPINION ESTABLISHING RULES FOR CALIFORNIA UTILITIES' SUBSCRIPTION TO TURNED BACK EL PASO PIPELINE CAPACITY

I. Summary

This decision establishes two rules for California natural gas utilities, Southern California Gas Company (SoCalGas), Pacific Gas and Electric Company (PG&E), San Diego Gas & Electric Company (SDG&E), and Southwest Gas Corporation (Southwest Gas), as well as California's largest electric utilities, Southern California Edison Company (Edison), PG&E, and SDG&E, concerning subscription to turned back capacity on the El Paso Natural Gas Company (El Paso) interstate pipeline. The first rule requires the natural gas and large electric utilities to sign up for proportionate amounts of El Paso turned back capacity at specified delivery points to the extent that California replacement shippers do not sign up for the turned back capacity, and the second rule finds just and reasonable the California utilities' subscription to this turned back capacity, as well as their existing capacity rights on interstate pipelines.

This decision also identifies issues for Phase II of this proceeding and sets a prehearing conference (PHC) for September 10, 2002 at 10:00 a.m., in San Francisco, California. Some issues to be explored in Phase II are: cost allocation,

capacity releases, and details concerning the guaranteed recovery in rates of the utilities'costs for subscription to interstate pipeline capacity.

II. Background

On June 27, 2002, the California Public Utilities Commission (Commission) issued an Order Instituting Rulemaking (OIR), Rulemaking (R.) 02-06-041, to consider requiring California natural gas and electric utilities to preserve interstate pipeline capacity to California. The OIR was in response to the May 31, 2002, Federal Energy Regulatory Commission (FERC) order indicating marketers currently serving California may turn back up to 725 million cubic feet per day (MMcf/d) of firm capacity on El Paso interstate pipeline to El Paso's East of California (EOC) customers. See El Paso Natural Gas Company, et al., 99 FERC ¶ 61,244 (2002) (May 31 Order). As a result of the May 31 Order, unless California replacement shippers or California utilities acquire the turned back capacity, it could be permanently lost to California. To ensure that California retains sufficient interstate pipeline capacity to meet the needs of its natural gas and electric customers, and to avoid the substantial reduction of capacity and resulting high gas and electric prices that occurred in the winter of 2000/2001, R.02-06-041 proposed rules to require California utilities to acquire capacity and address cost recovery. The utilities were directed, and other interested parties were invited, to file comments to the proposed rules.

Under the FERC's May 31 Order, El Paso's EOC customers must decide by July 31, 2002, how much El Paso capacity rights they will need for their Contract Demand (CD). The May 31 Order also found that marketers currently serving California under CD contracts are willing to turn back up to 725 MMcf/d of firm capacity which may be subscribed to by EOC customers, even though the turned back capacity is a substantial part of the 3,290 MMcf/d of El Paso capacity certificated to meet California's natural gas needs.

We were concerned that if no California replacement shipper acquires this turned back capacity, up to 725 MMcf/d of firm capacity on the El Paso system could be permanently lost to serve California customers. If there is a confluence of events, such as those that occurred in winter 2000/2001, the loss of 725 MMcf/d could have devastating impacts on both the supply and cost of gas and electricity for California customers. The marketers turning back capacity and potential California replacement shippers are not subject to our jurisdiction, so we have no authority over those entities. Therefore, we proposed rules directing the California utilities subject to our regulation to sign up for as much of this turned back capacity as possible. Because we must issue a decision in advance of July 31, 2002, the time for comments and reply comments on the proposed rules was shortened. Comments were due July 8, and replies July 12, 2002.

Comments were filed by the following: California Manufacturers and Technology Association (CMTA); Kinder Morgan Interstate Gas Transmission LLC (KMIGT); Mirant Americas, Inc. (Mirant); The Office of Ratepayer Advocates (ORA); The Utility Reform Network (TURN); SDG&E and SoCalGas; the County of San Bernadino (San Bernadino); West Coast Power[1]; Duke Energy North America, LLC and Duke Energy Trading and Marketing, LLC (Duke

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[1] West Coast Power is an entity formed to hold the ownership interests in Cabrillo I, LLC, Cabrillo II, LLC, El Segundo Power, LLC, and Long Beach Generation, LLC, which in turn own and operate electric generating plants formerly owned by SDG&E and Edison. The owners of West Coast Power are Dynegy and NRG Energy.

Energy); Kern River Gas Transmission Company and Questar-Southern Trails Pipeline Company (Kern River / Questar); Southern California Generation Coalition (SCGC); Calpine Corporation (Calpine); Edison; Southwest Gas; PG&E; Transwestern Pipeline Company (Transwestern); Watson Cogeneration Company (Watson); City of Long Beach (Long Beach); California Department of General Services (DGS); and Canadian Association of Petroleum Producers (CAPP).

Reply comments were filed by Energy, Minerals and Natural Resources Department of the State of New Mexico (New Mexico); El Paso; CAPP; TURN; Watson; PG&E; Kern River / Questar; Edison; SDG&E and SoCalGas; and Calpine.

III. Proposed Rules

The first proposed rule under consideration requires California's natural gas utilities, SoCalGas, PG&E, SDG&E, and Southwest Gas, and California's largest electric utilities, Edison, PG&E, and SDG&E, to each sign up for a proportionate amount of the turned back capacity not subscribed to by replacement shippers serving California. Because the May 31 Order does not require the marketers to turn back a specified amount of capacity, the Commission could not, and still cannot, identify a definitive amount of turned back capacity that each California utility should sign up for. In addition, we did not, and still do not, know how much turned back capacity, if any, the California replacement shippers might subscribe to.

The second proposed rule finds just and reasonable and pre-approves the California utilities' subscription to this turned back capacity. The purpose of the second rule is to guarantee that utility compliance with the requirement to sign up for turned back El Paso capacity cannot be the basis for a finding of unreasonableness.

IV. Discussion

A. The Expeditious Nature of This Rulemaking Proceeding

In their comments, many parties have complained about the expeditious nature and shortened time period to comment on the proposed rules. While the Commission sympathizes with the parties in this regard, as we pointed out in our OIR, the Commission has little choice but to shorten the time period for comments in light of the FERC's May 31 Order, which threatens California with the loss of up to 725 MMcf/d of El Paso capacity as early as July 31, 2002. In the FERC's May 31 Order, El Paso's EOC customers are required to decide by July 31, 2002 how much El Paso capacity rights they will need in their CD contracts. Under the FERC's May 31 Order, the capacity rationalization process involving the turnback by marketers serving California of up to 725 MMcf/d of El Paso capacity could be completed as early as July 31, 2002, and therefore, time is of the essence. In view of the timetable set by the May 31 Order, expedited procedures for comments on the proposed rules were necessary to allow us to ensure that a significant portion of El Paso's capacity to California is not lost.

In order to preserve necessary El Paso capacity to California, the Commission needs to issue this order before the end of July 2002. However, in recognition of the time constraints, we limited the issues for comments to just two proposed rules, and stated that other related issues would be addressed in a second phase, allowing parties, and the Commission, more time to address related matters.

B. The Significant Need for These Rules

While many commenters question the need for these rules, PG&E, Edison, DGS, Long Beach, and San Bernardino generally support the Commission's adoption of these rules. As we pointed out in the OIR, when California was deprived of almost 700 MMcf/d of El Paso capacity during the winter of 2000/2001, natural gas prices at the California border were at least two to three times higher than natural gas prices anywhere else in the nation. Indeed, even parties questioning the proposed rules, like TURN, recognize that during the winter of 2000/2001, the natural gas prices at the California border were two to three times and up to ten times higher than natural gas prices anywhere else in the nation.

There is a direct connection between the loss of interstate pipeline capacity to California and the high prices charged by marketers at the California border. In Public Utilities Commission of the State of California v. El Paso Natural Gas Company, et al., 97 FERC ¶61,380 at 62,740 (2001), the FERC recognized the need to investigate the unreasonably high California border prices during the period from November 2000 through March 31, 2001, when the FERC stated: "the question of whether El Paso Pipeline made all of its capacity available at its California delivery points is a uniquely important issue that requires further development because gas spot prices during this period were elevated to the $20 to $30 per MMBtu level, with price spikes as high as $60 per MMBtu." There is no dispute that during the winter of 2000/2001, El Paso only made available approximately 2,600 MMcf/d of interstate pipeline capacity, almost 700 MMcf/d less than El Paso's certificate obligation to California of 3,290 MMcf/d.

In light of this historical evidence, the potential loss of this same amount of capacity on the El Paso system presents a real threat to California of the adverse impacts suffered between November 2000 and March 31, 2001 if California utilities or other California replacement shippers do not sign up for the turned back capacity. In addition, as pointed out in the comments by Edison, high natural gas prices to California also result in high electric prices to California. We cannot afford to risk these high prices or natural gas shortages, which could result in blackouts in electricity or potential curtailments of natural gas in the future.

While parties did not and could not dispute the empirical evidence of what occurred in the past when California was deprived of approximately 700 MMcf/d of El Paso pipeline capacity, certain parties assert that the same devastation to California consumers would not occur in the future. Certain commenters contend that there would be less demand for natural gas in the future than during the years 2000/2001. For example, SoCalGas, TURN, and Duke Energy all referred to SoCalGas' forecast of less demand in SoCalGas' service territory. Ironically, at the same time that TURN and Duke Energy stated in their comments that SoCalGas had forecast less demand, both TURN and Duke Energy also stated that they were skeptical or disagreed with SoCalGas' forecast of demand in its service territory.

Time does not permit us to resolve the disputed SoCalGas demand forecast in this rulemaking, but we identify several reasons that we are not persuaded by the argument that lower demand forecasts mean we should not adopt the proposed rules.[2] For example, SoCalGas' disputed demand forecast is for its yearly totals. Yearly demand totals provide little assistance in ascertaining whether SoCalGas' customers' needs during peak summer or winter months can be met if California is deprived of up to 725 MMcf/d of El Paso capacity. The potential for exorbitant prices, blackouts, or natural gas curtailments would, in all likelihood, occur during peak times rather than on a yearly basis. We also note that there is no evidence that SoCalGas was able to forecast the high demand during the winter of 2000/2001 and adequately prepare for such high demand. Natural gas demand is dependent on numerous variables, including weather conditions and the operation and maintenance of non-fossil fueled power plants, which are not capable of forecasting with complete certainty. For these reasons, the Commission is not persuaded that we can risk a significant loss of El Paso capacity to Southern California in the near future. It is therefore vital that the California utilities sign up for as much as possible of the turned back capacity on the El Paso system to help ensure that the California natural gas and electric consumers do not experience these adverse impacts again.

Many commenters also questioned whether the loss of a significant amount of El Paso capacity would result in adverse impacts in light of the new interstate pipeline expansions that have been completed or are projected in the future for California. ORA, TURN, CMTA, Duke Energy, West Coast Power, SoCalGas and SDG&E, Mirant, Watson, Kern River/Questar, SCGC, and CAPP have all identified various volumes for current and expected expansions of pipelines to California.

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[2] In terms of Northern California, PG&E states that it expects load growth in its service territory. No party has challenged PG&E's expectation of such load growth.

There are three fundamental problems with the statistics concerning expansions of pipelines to California. First, many of the volumes listed will be used to serve markets other than California but are included in the total capacity identified to serve California. For example, numerous parties referred to El Paso's expansion of its Line 2000, yet in the FERC's May 31 Order, the FERC stated that the El Paso Line 2000 expansion would be utilized to meet El Paso's EOC customers' needs. Similarly, PG&E Gas Transmission Northwest Corporation's (PG&E Gas Transmission) expansions include substantial amounts of capacity to markets in states north of California. For example, in <u>PG&E Gas Transmission Northwest Corporation</u>, 96 FERC ¶61,194 at 61,835 (2001), the FERC reports that of the 210,800 decatherm/day (Dth/d) of capacity that PG&E Gas Transmission proposed to increase for its pipeline facilities, 175,000 Dth/d of annual capacity was committed to a Washington generator, Newport Northwest, LLC, for a 52-year term. In addition, the proposed Kern River Expansion of 885 MMcf/d of capacity would provide a significant amount of service to electric generation plants in Nevada. <u>See</u> <u>Kern River Gas Transmission Company</u>, 98 FERC ¶61,205 at 61,719 (2002). Therefore, these expansion volumes cannot be assumed to be available to serve California.

Second, these expansions were justified by additional and growing need for interstate pipeline capacity, presupposing that the entire 3,290 MMcf/d of El Paso's certificated capacity to California continued. Thus, for example, the FERC justified the Kern River expansion of 885 MMcf/d of capacity based upon the new electric generation in Nevada and California, which "will require additional supplies considerably in excess of the proposed 2003 Expansion Project." <u>Id</u>. at 61,718. Therefore, these expansions were driven by the additional need for natural gas, assuming all of the El Paso certificated capacity to

California (i.e. 3,290 MMcf/d) was available to serve California. However, as a result of the FERC's May 31 Order, California is now threatened with the loss of up to 725 MMcf/d of El Paso capacity that may be subscribed to by El Paso's EOC customers.[3]

The third problem concerning reliance on the expansions is the time lag before the significant amount of additional capacity is operational and can serve California (and other markets). Specifically, Kern River's 885 MMcf/d of expansion capacity is purportedly "planned" to be in service by May 2003, but at the time our OIR was issued the FERC had not yet certificated this Kern River expansion project.[4] The FERC has given Kern River up to two years after the certificate is issued for the expansion project to become operational. Id. at 61,726.

[3] In this regard, certain of the commenters' reliance upon the November 2001 "California Natural Gas Infrastructure Outlook" is misplaced. First, this report had found sufficient capacity to California assuming the full 3,290 MMcf/d of El Paso capacity to California was available, an assumption that is now threatened by the capacity rationalization process as marketers turn back capacity previously being used to serve California. Second, this report does not represent the official views of the Commission. At the very beginning of this report before there is even a table of contents, there is the following disclaimer: "**This Report Does Not Pre-Judge Official Commission Proceedings**" (emphasis added), and it further states that in order to prepare this report, "the CPUC has relied extensively upon data provided by the utilities, the CEC, and other parties. As part of the CPUC's ongoing regulation of the natural gas industry, some of the data and assumptions contained in this report are currently, or may in the future be contested in proceedings before the CPUC … To avoid pre-judging the outcome of these proceedings, and to preserve due process rights for all interested parties, the data and assumptions contained in the report are subject to further verification and revision until officially adopted by the CPUC in the course of a proceeding."

[4] Kern River's expansion project is in FERC Docket No. CP01-422-000, which is on the agenda for the FERC conference on July 17, 2002. Therefore, the FERC may be issuing the certificate to Kern River at the FERC's July 17, 2002 conference.

In the meantime, if substantial amounts of existing El Paso capacity are lost now, during the summer and winter peaks of 2002 and 2003, California could suffer extremely adverse impacts awaiting completion and operation of the Kern River expansion. This problem of interstate pipeline capacity during the interim, before this major Kern River expansion project can be completed, was recognized by the FERC when it referred to and quoted the Energy Information Administration's October 2001 report. The report cited by the FERC described Kern River's expansions, noted Kern River's growing markets in California and Nevada, and observed that: "Kern River is expected to complete its system-wide expansion and double its current capacity in 2003. Until then, the pipeline will have difficulty meeting the needs of both markets." See Kern River Gas Transmission Company, 98 FERC ¶61,205 at 61,719. (Emphasis added.) Significantly, when the FERC stated that the Kern River pipeline will have difficulty meeting the needs of both markets in California and Nevada prior to the completion of its major expansion project, the assumption was that El Paso's existing capacity of 3,290 MMcf/d to California was available during that time period to meet California's needs. In light of the FERC's May 31 Order, which calls into questions this assumption, it may be even more difficult for the existing pipeline capacity to meet California's needs if the turned back capacity is not signed up for by California replacement shippers.

For these reasons, the Commission finds that there is still a significant need to preserve existing El Paso interstate pipeline capacity to California in the near future, and therefore we will order the California utilities to sign up for as much turned back capacity as possible at this time.

C. Clarification of The Rules

The Commission proposed two rules addressing the turnback of El Paso capacity. The first proposed rule requires California's natural gas utilities, SoCalGas, PG&E, SDG&E, and Southwest Gas, as well as California's largest electric utilities, Edison, PG&E, and SDG&E, to sign up for as much of the El Paso turned back capacity as possible at the appropriate El Paso delivery points, unless other California replacement shippers sign up for the turned back capacity. The second proposed rule states that the Commission preapproves and finds just and reasonable the California utilities' subscription to this turned back capacity. In their comments, SoCalGas and SDG&E asked to be exempt from the rules, because SoCalGas has interstate capacity rights in excess of its core customers needs. These comments, however, do not provide any basis for exempting SDG&E from signing up for turned back capacity, because there was no evidence presented that SDG&E has enough interstate pipeline capacity rights to meet its core customers' needs. In any event, the Commission denies SoCalGas' and SDG&E's request to be exempt from these rules for the following reasons.

First, it does not make sense to exempt these Southern California utilities from these rules, considering that Southern California border prices were much higher than Northern California border prices or anywhere else in the nation from June 2000 through May 31, 2001, when El Paso was depriving the California market of up to 700 MMcf/d of capacity. As the FERC's Chief Administrative Law Judge found in <u>Public Utilities Commission of the State of California v. El Paso Natural Gas Company, et al.</u>, 97 FERC ¶63,004 at 65,017 (2001), during this time period, prices in Northern California were substantially lower than prices in Southern California.

The Commission also takes official notice of the daily prices reported in Gas Daily for this time period, and notes that the Southern California border prices were regularly higher than Northern California border prices and that the $60 per MMbtu price during December 2000 was only at the Southern California border. It is obvious that SoCalGas' and SDG&E's noncore customers, who purchased natural gas at the California border (or under contracts pegged to the border prices or basis differentials), were the entities most harmed when El Paso deprived the California market of up to 700 MMcf/d during the years 2000 and 2001. To the extent that SDG&E, and to a limited extent SoCalGas, purchased natural gas during this time period at the California border (or under contracts pegged to the border prices or basis differentials) for their core customers, they were also harmed. Therefore, considering that the goal of our rules is to prevent these adverse impacts from occurring again in both the core and noncore markets, and that the harshest impacts of loss of capacity were previously felt in Southern California, there is no basis to exempt SoCalGas or SDG&E from these rules.

Secondly, the Commission seeks to spread the costs of the turned back capacity over as many ratepayers as possible so that the impact of turned back capacity costs will be minimal on any particular utility's customers. All of California benefits from preserving the existing interstate pipeline capacity that has historically served California, and, therefore, all California natural gas and electric ratepayers should pay for preserving this capacity. For this reason, we also reject Long Beach's suggestion that <u>only</u> SoCalGas and PG&E sign up for the turned back capacity.

ORA, TURN, CMTA, SoCalGas and SDG&E, PG&E, CMTA, and Watson argue that it would be a change of Commission policy to require any

California utility to sign up for capacity to serve the noncore, and we agree that this would be a deviation from previous policies. However, in light of the emergency facing California, which would harm noncore customers as well as core customers of the utilities, this limited deviation from our previous policies is necessary. As stated above, the noncore customers would benefit from preserving sufficient interstate pipeline capacity to serve California's needs. Therefore, to the extent that noncore customers or other shippers serving California do not themselves sign up as replacement shippers for the turned back capacity, the utilities should sign up for the turned back capacity and, in turn, release capacity (in excess of their needs) to noncore customers (or marketers serving noncore customers) under short-term capacity release arrangements. This deviation from previous Commission policy is justifiable in that we are dealing with an emergency situation facing California and in light of the empirical evidence of how much noncore customers were harmed when there was not sufficient capacity to meet California's needs during the winter of 2000/2001. Requiring utilities to subscribe to this capacity ensures that it is available to meet core needs or noncore needs in California. The utilities' short-term capacity releases will ensure that the capacity is not withheld from the California market.

In its reply comments, PG&E states that "no party questions the correctness of the Commission's fundamental conclusion that interstate pipeline capacity holdings by the utilities can provide an important hedge against price spikes, as well as reliability benefits, for core customers. The experience of 2000-2001 has shown that interstate capacity is cheap relative to the cost of a price spike to consumers." We agree with these statements by PG&E, but we also find that, faced with a potential loss of a substantial amount of El Paso capacity that has historically served California, the preservation of this turned back capacity by California replacement shippers or California utilities would also provide an important hedge against price spikes, as well as reliability benefits, for noncore customers and electric ratepayers who were also the victims of price spikes in 2000-2001. Moreover, spreading the costs of the utilities' subscription to turned back capacity (that is not otherwise subscribed to by other California replacement shippers) to the ratepayers of all four California natural gas utilities and the three largest California electric utilities, makes the intrastate transportation rate impact even more minimal (relative to the cost of a price spike) than the relatively small rate impact from just requiring PG&E's core ratepayers to pay for the subscription to turned back capacity.

In their reply comments, Calpine and Watson state that the representatives of noncore customers who filed opening comments were unanimous in their opposition to the utilities signing up for turned back capacity for noncore customers. This is not true, because DGS, which represents 130 noncore customers in Northern and Southern California, filed initial comments supporting the requirement that utilities sign up for turned back capacity and release the capacity to noncore customers. DGS' initial comments recognize that such actions are necessary in order to make sure that California has adequate interstate pipeline capacity to serve its needs.

We emphasize that the California utilities would only sign up for turned back capacity to meet noncore customers' needs to the extent that other California replacement shippers do not subscribe to the turned back capacity, and we encourage other California replacement shippers to promptly inform the utilities if and when the California replacement shippers have signed up for turned back capacity. However, we are very concerned that noncore customers, such as DGS, cannot quickly sign up for five-year contracts for turned back capacity in light of the expeditious capacity rationalization process under the FERC's May 31 Order. Indeed, since many noncore customers do not participate in FERC proceedings, they may be unaware of the urgent need to sign up quickly for the turned back capacity. In this unique circumstance, it is necessary and appropriate for the California utilities to act as a backstop for their noncore customers in order to ensure adequate interstate pipeline capacity to California.

In this regard, we reject the suggestion in the reply comments of Watson and Kern River/Questar that we wait until after the capacity rationalization process is completed to see if it is necessary for the California utilities to sign up for turned back capacity rights. If we wait until the capacity rationalization process is over, it would be too late for the California utilities to sign up for turned back capacity and our goal of preserving adequate interstate pipeline capacity for California would be totally undermined. The California natural gas and electric consumers cannot afford another energy crisis, and we are requiring the California utilities to take these actions in the face of an imminent threat of El Paso abandoning a substantial portion of its service to California over pipeline facilities that are certificated to meet California's needs.

In the comments of PG&E, Edison, Southwest Gas, SoCalGas, and SDG&E on the second rule concerning preapproval of the California utilities signing up for the capacity, the utilities support preapproval and guaranteed recovery of the costs associated with the turned back capacity. On the other hand, in the comments of CMTA and Calpine, they oppose such preapproval and allege that the utilities may pay too high a price for the turned back capacity if there is preapproval.

The Commission clarifies that preapproval and the finding of just and reasonable rates for signing up for the turned back capacity is guaranteed only to the extent the utilities pay no more than the maximum tariffed transportation rate on the El Paso pipeline. With this clarification, we reject the opposition to our preapproval of the utilities signing up for the turned back capacity. By signing up for this capacity and preserving existing interstate pipeline capacity to help ensure that peak needs of California natural gas consumers are met and that electric generators are not deprived of necessary natural gas at reasonable prices, the utilities provide benefits to California. Moreover, the utilities would be complying with a Commission order as encompassed in our first rule herein, and, therefore, there is no basis to disallow costs of the utilities in securing and signing up for the turned back capacity.

PG&E, Edison, and ORA request further guidance as to volumes the utility should subscribe to. As explained in our OIR, the Commission cannot be explicit in light of the moving target with which we are dealing. For example, we will not know by July 17, 2002, how much capacity that was previously serving California is being turned back by the shippers and may be signed up for by EOC customers of El Paso, nor will we know what specific delivery points would be served by the capacity that is turned back. We will not know if California replacement shippers (other than the utilities) sign up for the turned back capacity or how much capacity to which they will subscribe. We therefore have provided that each of the utilities should sign up for a proportionate amount of the turned back capacity in light of their historic use of the El Paso system, and considering the delivery points that the turned back capacity serves. Our references to the historic usage was simply in recognition of the fact that Edison, SDG&E and PG&E have divested natural gas-fired power plants, but had previously utilized El Paso to a much greater extent than they do today. Whether or not the current owners of these power plants care about keeping their natural gas costs and electric rates low, the electric ratepayers of Edison, SDG&E and PG&E benefit from lower natural gas costs and electric rates due to the availability of sufficient El Paso capacity to California. Therefore, the California electric utilities' ratepayers should help pay for the turned back capacity costs.

We stated in our OIR, and reconfirm here, that PG&E is expected to sign up for capacity turned back at the PG&E-Topock delivery point on the El Paso system, and the other four utilities should sign up for turned back capacity at the two El Paso delivery points accessing directly the SoCalGas system (i.e., Ehrenberg and SoCal-Topock). No utility should be expected to sign up for turned back capacity that is solely at the Mojave delivery point on the El Paso pipeline.

California utilities should sign up for as much of this turned back capacity as possible. We do not expect the California utilities to sign up for all of the turned back capacity, but they should preserve as much of the 3,290 MMcf/d of certificated El Paso capacity for California as possible. For example, if 725 MMcf/d of capacity were turned back and no California replacement shippers signed up for that turned back capacity, assuming that 300 MMcf/d was turned back at Ehrenberg and SoCal-Topock (the two delivery points directly accessing the SoCalGas system), 300 MMcf/d was turned back at the PG&E-Topock delivery point and 125 MMcf/d was turned back at the Mojave delivery point, we would expect that the two largest California natural gas utilities, PG&E and SoCalGas, would each sign up for at least 200 MMcf/d (or 67%) of the turned back capacity at their respective delivery points. We would further expect that between Edison, SDG&E, and Southwest Gas, they would sign up for most of the remaining 100 MMcf/d at the Southern California delivery points. For example, Edison and SDG&E could each sign up for at least 40 MMcf/d (or 13%) and Southwest Gas could sign up for at least 10 MMcf/d (or 4%) of the turned back capacity at the Southern California delivery points.

We also expect that no California utility would sign up for the turned back capacity at the Mojave delivery point because this would require an incremental transportation charge on Mojave to reach the utility's service territory. Thus, in addition to the Mojave capacity not being subscribed to by the California utilities, a portion of the other turned back capacity may also be available for El Paso EOC customers, in addition to El Paso's expansion capacity that is available only to its EOC customers. Our rules are based upon preservation of a substantial amount of the turned back capacity that has historically served California, and we provide the above quantities and percentages as examples of how this can be accomplished.

PG&E, SoCalGas and SDG&E, and Southwest Gas further emphasize in comments that they should be guaranteed recovery of their existing interstate pipeline capacity rights if they are being expected to also sign up for additional capacity rights. Otherwise, PG&E and SoCalGas suggest that they may relinquish some of their existing capacity rights for which they are at risk or do not fully utilize. In its reply comments, TURN opposes the utilities' proposal for guaranteed recovery of their existing interstate pipeline capacity rights.

The Commission agrees with the California utilities that under current market conditions and in light of the benefits to California of utility retention of existing interstate pipeline capacity rights, it is just and reasonable for the California utilities to keep their existing capacity rights and perform short-term capacity releases when they do not need to utilize all of their capacity rights. Therefore, we find that to the extent the California utilities comply with our new rules, they should also be compensated in full by their ratepayers for the costs of their existing capacity rights on interstate pipelines. The details as to how various mechanisms for recovery of these costs (e.g., PG&E's core procurement incentive mechanism) or rates should be adjusted to reflect this policy will be addressed in Phase II of this proceeding, where other parties will be able to comment on any necessary adjustments to these mechanisms.

In addition, because of the need to preserve interstate pipeline capacity to California, no California utility should turn back existing capacity rights on any interstate pipeline to California at this time. Whereas SoCalGas has proposed turning back capacity, this would contribute to the problem of California losing necessary interstate pipeline capacity. In this proceeding, we are requiring the California utilities, including SoCalGas, to be part of the solution, rather than to allow them to be part of this problem. In this regard, we agree with the reply comments of PG&E that SoCalGas' turnback proposal should also be rejected, because if PG&E were required to sign up for SoCalGas' turned back capacity, it would limit PG&E's ability to acquire additional turned back capacity. This would be contrary to our objectives.

We also agree with the comments of Long Beach that no California utility should enter into any new long-term capacity release arrangement at this time so that there is no loss of control of capacity rights over a long period of time, but the California utilities should engage in short-term capacity release transactions. The Commission will review this policy, if necessary, during Phase II of this proceeding or, in subsequent Commission decisions. The final rules that we are issuing today are attached as Appendix A to this decision.

V. Phase II Issues

One of the most contentious issues identified in the comments revolves around allocation of turned back capacity costs between core and noncore customers of the utilities. Extensive comments on the allocation issues were filed. Whereas ORA and TURN argue that core ratepayers of the natural gas utilities should not pay for any of the turned back capacity costs, Duke Energy, West Coast Power, CMTA, Mirant, and SCGC argue that only core ratepayers should pay for the turned back capacity costs. In its comments, PG&E states that it needs to sign up for some capacity to meet its core customers needs but does not believe it should sign up for capacity for its noncore customers. As stated above, the Commission expects the utilities to sign up for capacity, to meet core and noncore customer needs, and we therefore require California natural gas utilities and California electric utilities to sign up for turned back capacity. We also made clear in our OIR that how costs will be allocated among a particular utility's customers would have to be decided in Phase II, in light of the limited time we have to issue the proposed rules under the FERC's timetable. We therefore will not rule on specific allocation issues at this time and will fully address all of the parties' concerns during Phase II in this proceeding. We do clarify here that each utility's costs associated with acquiring turned back capacity will be recovered in its own customers' rates and the allocation between core and noncore customers, and gas and electric operations, may differ by utility depending on the utility's specific situation.

Numerous parties also raised concerns about market signals being sent by adoption of these rules and about the need to diversify supply among various interstate pipelines to California. Not surprisingly, this was the focus of the comments of Kern River/Questar, Transwestern, KMIGT, and New Mexico.

This concern about future policies was also expressed in the comments by PG&E, SoCalGas and SDG&E, Calpine, ORA, CMTA, and Watson. We could consider these matters in Phase II of the proceeding or in subsequent Commission proceedings. We are adopting these rules in an emergency context, where we are attempting to preserve as much as possible of the existing infrastructure that has historically served California. This decision is not intended to send long-term market signals and is without prejudice to future decisions about diversification, utility responsibility for noncore customers, and other issues that have been raised by the parties in comments. Simply because we are dealing with an emergency now, does not mean there cannot be future adjustments to the capacity signed up for by the California utilities. In the future, we expect to reconsider long-term capacity releases by the California utilities, and the FERC's May 31 Order itself contemplates future opportunities for the turnback of capacity to meet the growing EOC customers' needs. Thus, the Commission can authorize the California utilities to adjust their interstate pipeline capacity holding as we explore these further policies in Phase II and/or subsequent Commission proceedings. Moreover, in the future when there are growing needs by the California natural gas consumers, there will undoubtedly be more opportunities for the diversification of supplies.

In their comments, PG&E and Edison asked for the Commission to rule at this time on capacity release issues and preapprove or presume reasonable all conduct involving capacity releases of the interstate pipeline capacity. Except for our requirements that the utilities no longer enter into long-term capacity releases at this time and that they engage in short-term capacity releases for capacity which they cannot utilize, we cannot address other capacity release issues in the short time frame we have to issue these rules. Therefore, we will not preapprove or presume reasonable all conduct involving capacity releases, and we will review any other pertinent capacity release issues in Phase II in this proceeding, as necessary.

In its comments, PG&E also recognizes that the details of adjustments of its core procurement incentive mechanism should be addressed in Phase II. Any necessary adjustments to gas cost incentive mechanisms or other rates to address the details of the turnback capacity cost recovery, as well as the existing interstate pipeline capacity cost recovery, will be dealt with in Phase II of this proceeding.

There may be additional issues that parties will want to raise in Phase II, so the Commission is not limiting Phase II issues to only the above-mentioned issues.

VI. Public Review and Comment

Pursuant to Rule 77.7(f)(9) of the Commission's Rules of Practice and Procedure, the 30-day period for public review and comment may be reduced or waived if public necessity for action outweighs the public interest in providing for the 30-day period for public review and comment. If the California gas and electric utilities are not ordered to subscribe to the turned back capacity before July 31, 2002, when the EOC customers must determine their needs on the El Paso pipeline, California could permanently lose up to 725 MMcf/d of El Paso capacity, putting California customers at risk for gas and electric power shortages and unreasonably high prices. In addition, the parties were provided with an opportunity to comment on the proposed rules set forth in the rulemaking. Because the turned back capacity may only be available for subscription through July 31, 2002, we determine that the public interest in adopting a decision without review and comment on the decision clearly outweighs the public interest in having the full 30-day period for public review and comment.

Findings of Fact

1. The FERC issued a May 31 Order indicating marketers currently serving California may turn back up to 725 million cubic feet per day (MMcf/d) of firm capacity on El Paso interstate pipeline to El Paso's East of California (EOC) customers.

2. We will not know by July 17, 2002, how much capacity that was previously serving California is being turned back by the shippers and may be signed up for by EOC customers of El Paso, nor will we know what specific delivery points would be served by the capacity that is turned back.

3. If no California replacement shipper acquires this turned back capacity, up to 725 MMcf/d of firm capacity on the El Paso system could be permanently lost to serve California customers.

4. Under the FERC's May 31 Order, the capacity rationalization process involving the turnback by marketers serving California of up to 725 MMcf/d of El Paso capacity could be completed as early as July 31, 2002.

5. When California was deprived of almost 700 MMcf/d of El Paso capacity during the winter of 2000/2001, natural gas prices at the California border were at least two to three times higher than natural gas prices anywhere else in the nation.

6. There is no dispute that during the winter of 2000/2001, El Paso only made available approximately 2,600 MMcf/d of interstate pipeline capacity, almost 700 MMcf/d less than El Paso's certificate obligation to California of 3,290 MMcf/d.

7. High natural gas prices to California result in high electric prices to California.

8. Natural gas demand is dependent on numerous variables, including weather conditions and the operation and maintenance of non-fossil fueled power plants, which are not capable of forecasting with complete certainty.

9. Many of the expansion volumes listed by parties will be used to serve markets other than California but are included in the total capacity identified to serve California.

10. Expansions identified by parties were justified by additional and growing need for interstate pipeline capacity, presupposing that the entire 3,290 MMcf/d of El Paso's certificated capacity to California continued.

11. The FERC found that the Kern River pipeline will have difficulty meeting the needs of markets in both California and Nevada prior to the completion of its major expansion project, even assuming that El Paso's existing capacity of 3,290 MMcf/d to California was available during that time period to meet California's needs.

12. There is a significant need to preserve existing El Paso interstate pipeline capacity in the near future.

13. Southern California border prices were much higher than Northern California border prices or anywhere else in the nation from June 2000 through May 31, 2001, when El Paso was depriving the California market of up to 700 MMcf/d of capacity.

14. Core and noncore customers benefit from preserving sufficient interstate pipeline capacity to serve California's needs.

15. Electric ratepayers of Edison, SDG&E and PG&E benefit from lower natural gas costs and electric rates due to the availability of sufficient El Paso capacity to California.

16. Spreading the costs of turned back capacity over as many ratepayers as possible minimizes the impact of turned back capacity costs on any particular utility's customers.

17. Requiring utilities to subscribe to turned back capacity ensures that it is available to meet core or noncore needs in California through short-term capacity releases, and is not withheld from the California market.

Conclusions of Law

1. In view of the timetable set by the May 31 Order, expedited procedures for comments on the proposed rules were necessary to allow us to ensure that a significant portion of El Paso's capacity to California is not lost.

2. The potential loss of 725 MMcf/d of capacity on the El Paso system presents a real threat to California of the adverse impacts suffered between November 2000 and March 31, 2001 if California utilities or other California replacement shippers do not sign up for the turned back capacity.

3. Yearly demand totals provide little assistance in ascertaining whether SoCalGas' customers' needs during peak summer or winter months can be met if California is deprived of up to 725 MMcf/d of El Paso capacity.

4. In light of the FERC's May 31 Order, which calls into question the assumption that 3,290 MMcf/d of capacity on El Paso is available to serve California, it may be even more difficult for existing pipeline capacity to meet California's needs if turned back capacity is not signed up for by California replacement shippers or California utilities.

5. All of California benefits by preserving the existing interstate pipeline capacity that has historically served California, and, therefore, all California natural gas and electric ratepayers should pay for preserving this capacity.

6. To the extent that noncore customers or other shippers serving California do not themselves sign up as replacement shippers for the turned back capacity, the utilities should sign up for the turned back capacity at appropriate El Paso delivery points and, in turn, release capacity (in excess of their needs) to noncore customers (or marketers serving noncore customers) under short-term capacity release arrangements.

7. Deviation from previous Commission policy is justifiable in that we are dealing with an emergency situation facing California and in light of the empirical evidence of how much noncore customers were harmed when there was not sufficient capacity to meet California's needs during the winter of 2000/2001.

8. Preapproval and a finding of just and reasonable rates for signing up for the turned back capacity should be guaranteed to the extent the utilities pay no more than the maximum tariffed transportation rate on the El Paso pipeline.

9. By signing up for this capacity and preserving existing interstate pipeline capacity to help ensure that peak needs of California natural gas consumers are met and that electric generators are not deprived of necessary natural gas at reasonable prices, the utilities provide benefits to California.

10. PG&E should sign up for capacity turned back at the PG&E-Topock delivery point on the El Paso system, and the other four utilities should sign up for turned back capacity at the two El Paso delivery points accessing directly the SoCalGas system (i.e., Ehrenberg and SoCal-Topock).

11. No California utility should sign up for the turned back capacity at the Mojave delivery point because this would require an incremental transportation charge on Mojave to reach the utility's service territory.

12. Under current market conditions and in light of the benefits to California of utility retention of existing interstate pipeline capacity rights, it is just and reasonable for the California utilities to keep their existing capacity rights and perform short-term capacity releases when they do not need to utilize all of their capacity rights.

13. Each utility's costs associated with acquiring turned back capacity will be recovered in its own customers' rates but the allocation between core and noncore customers, and gas and electric operations, may differ by utility depending on the utility's specific situation.

14. This decision is not intended to send long-term market signals and is without prejudice to future decisions about diversification, utility responsibility for noncore customers, and other issues that have been raised by the parties in comments.

15. How costs will be allocated among a particular utility's customers would have to be decided in Phase II.

16. It is reasonable to waive the period for comment and review of the draft decision, pursuant to Rule 77.7(f)(9).

O R D E R

Therefore, **IT IS ORDERED** that:

1. The Rules set forth in Appendix A are adopted.

2. Southern California Gas Company, Pacific Gas and Electric Company, San Diego Gas & Electric Company, Southwest Gas Company, and Southern

California Edison Company shall subscribe to turned back capacity on the El Paso Pipeline Company consistent with the Rules set forth in Appendix A and this Opinion, and shall be guaranteed cost recovery for such subscriptions, as set forth in Appendix A.

3. To the extent that the California utilities comply with these Rules and this Opinion, they shall also receive full cost recovery for their costs associated with their existing capacity rights on interstate pipelines.

4. No California utility shall turn back capacity rights on interstate pipelines or release their capacity rights under long-term capacity release transactions unless and until the Commission subsequently authorizes such turn back of capacity or long-term releases.

5. California utilities are authorized to release capacity rights under short-term capacity release transactions.

This order is effective today.

Dated July 17, 2002, at San Francisco, California.

LORETTA M. LYNCH
President
CARL W. WOOD
GEOFFREY F. BROWN
Commissioners

I dissent.

/s/ HENRY M. DUQUE

I will file a dissent.

/s/ MICHAEL R. PEEVEY
Commissioner

APPENDIX A

RULES

A. Definitions

1. "El Paso" as used herein means the El Paso Natural Gas Company interstate natural gas pipeline

2. "El Paso's Southern California delivery points" as used herein means El Paso's delivery points interconnecting with Southern California Gas Company's intrastate system at Topock or Ehrenberg.

3. "El Paso's PG&E-Topock delivery point" as used herein means El Paso's delivery point interconnecting with Pacific Gas and Electric Company's intrastate system at Topock.

4. "Turned back capacity" as used herein means the El Paso firm capacity rights, currently held by shippers serving California that marketers may decide to turn back to El Paso based upon the Federal Energy Regulatory Commission's ("FERC") May 31, 2002 order. See El Paso Natural Gas Company, et. al., 99 FERC ¶ 61,244 (2002).

5. "California replacement shippers" as used herein means any shippers (e.g., marketers or California end-users) willing to sign up for the turned back capacity and continue to use that capacity to transport natural gas to California.

6. "Proportionate amounts" as used herein means the Southern California utilities' fair share of the turned back capacity, taking into account their historic use of natural gas and El Paso capacity on behalf of all of their customers.

B. Subscription to Turned Back Capacity

1. Southern California Gas Company, Southern California Edison Company, San Diego Gas & Electric Company, and Southwest Gas Corporation shall sign up in proportionate amounts for as much El Paso turned back capacity as

possible at El Paso's Southern California delivery points to the extent that California replacement shippers do not sign up for the turned back capacity.

2. Pacific Gas and Electric Company shall sign up for as much El Paso turned back capacity as possible at El Paso's PG&E-Topock delivery point to the extent that other California replacement shippers do not sign up for the turned back capacity.

3. After the above-mentioned California utilities sign up for the turned back capacity, they shall use this capacity for their own needs or offer this capacity in the short-term capacity release market to California replacement shippers.

4. These utilities shall file a report with Energy Division stating the amount of turned back capacity (and at which delivery points) to which they subscribed and shall report quarterly to Energy Division on any short-term capacity releases.

C. Pre-approval of subscription

The California utilities' compliance with the above-mentioned rule (i.e., B. Subscription to Turned Back Capacity) is pre-approved by the Commission and found to be just and reasonable provided that the California utilities acquire the turned back capacity at no more than the maximum tariffed rate. To the extent that the California utilities comply with the above-mentioned rule, they should be fully compensated in their rates for the costs associated with their subscription to the turned back capacity, as well as for the costs associated with their existing capacity rights on interstate pipelines.

(END OF APPENDIX A)